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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the quarterly period ended September 30, 2000

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 000-27115

PCTEL, Inc.
(Exact Name of Business Issuer as Specified in Its Charter)

Delaware 77-0364943
(State or Other Jurisdiction of (I.R.S. Employer Identification Number)
Incorporation or Organization)

1331 California Circle, Milpitas, CA 95035
(Address of Principal Executive Office) (Zip Code)

(408) 965-2100
(Registrant's Telephone Number, Including Area Code)

Indicate by checkmark whether the Registrant: (1) has filed all reports required
to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months
(or for such shorter period that the registrant was required to file such
reports), and (2) has been subject to such filing requirements for the past 90
days.

Yes ☒ No ☐

As of October 31, 2000, there were 18,571,654 shares of the Registrant's Common
Stock outstanding.

PCTEL, Inc.

Form 10-Q

For the Quarter Ended September 30, 2000

Page

PART I.	Financial Information	
ITEM 1	Financial Statements	
	Consolidated Condensed Balance Sheets as of September 30, 2000 (unaudited) and December 31, 1999	3
	Consolidated Condensed Statements of Operations (unaudited) for the three and nine months ended September 30, 2000 and 1999	4
	Consolidated Condensed Statements of Cash Flows (unaudited) for the nine months ended September 30, 2000 and 1999	5
	Notes to the Consolidated Condensed Financial Statements (unaudited)	6
ITEM 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	15
ITEM 3	Quantitative and Qualitative Disclosures About Market Risk	28
PART II.	Other Information	
ITEM 1	Legal Proceedings	29
ITEM 2	Changes in Securities and Use of Proceeds	29
ITEM 3	Defaults upon Senior Securities	29
ITEM 4	Submission of Matters to a Vote of Security Holders	29
ITEM 5	Other Information	29
ITEM 6	Exhibits and Reports on Form 8-K	29

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

PCTEL, Inc.

CONSOLIDATED CONDENSED BALANCE SHEETS
(in thousands, except share information)

	September 30, 2000 ----- (Unaudited)	December 31, 1999 -----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 76,488	\$ 44,705
Short-term investments	55,211	53,585
Accounts receivable, net	18,168	6,555
Inventories, net	8,771	5,741
Prepaid expenses and other assets	1,829	2,422
Deferred tax asset	3,455	3,211
	-----	-----
Total current assets	163,922	116,219
PROPERTY AND EQUIPMENT, net	4,557	3,099
GOODWILL AND OTHER INTANGIBLE ASSETS, net	21,408	8,649
DEFERRED TAX ASSET	2,365	2,365
OTHER ASSETS	340	273
	-----	-----
TOTAL ASSETS	\$ 192,592 =====	\$ 130,605 =====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 7,634	\$ 7,140
Accrued royalties	10,827	7,868
Income taxes payable	4,251	3,290
Accrued liabilities	10,181	8,029
	-----	-----
Total current liabilities	32,893	26,327
	-----	-----
STOCKHOLDERS' EQUITY:		
Common stock, \$0.001 par value, 50,000,000 shares authorized; 18,540,805 and 16,560,335 shares issued and outstanding at September 30, 2000 and December 31, 1999, respectively	19	17
Additional paid-in capital	145,287	99,334
Deferred compensation	(3,325)	(4,856)
Retained earnings	17,746	9,849
Accumulated other comprehensive loss	(28)	(66)
	-----	-----
Total stockholders' equity	159,699	104,278
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 192,592 =====	\$ 130,605 =====

The accompanying notes are an integral part of these consolidated condensed financial statements.

PCTEL, Inc.

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(in thousands, except per share information)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2000	1999	2000	1999
REVENUES	\$ 28,885	\$ 20,190	\$ 80,529	\$ 53,236
COST OF REVENUES	15,314	10,440	42,678	27,437
GROSS PROFIT	13,571	9,750	37,851	25,799
OPERATING EXPENSES:				
Research and development	3,900	2,732	11,609	7,155
Sales and marketing	3,660	2,609	10,385	7,554
General and administrative	2,191	1,571	5,669	3,634
Acquired in-process research and development	-	-	1,600	-
Amortization of goodwill	811	-	1,827	-
Amortization of deferred compensation (See Note 5)	320	287	997	451
Total operating expenses	10,882	7,199	32,087	18,794
INCOME FROM OPERATIONS	2,689	2,551	5,764	7,005
OTHER INCOME, net:				
Interest income (expense), net	2,008	(155)	5,166	(747)
INCOME BEFORE PROVISION FOR INCOME TAXES	4,697	2,396	10,930	6,258
PROVISION FOR INCOME TAXES	1,319	717	3,033	1,875
NET INCOME	\$ 3,378	\$ 1,679	\$ 7,897	\$ 4,383
Basic earnings per share	\$ 0.18	\$ 0.67	\$ 0.45	\$ 1.78
Shares used in computing basic earnings per share	18,441	2,512	17,745	2,462
Diluted earnings per share	\$ 0.16	\$ 0.12	\$ 0.38	\$ 0.34
Shares used in computing diluted earnings per share	20,561	13,438	20,638	12,858

The accompanying notes are an integral part of these consolidated condensed financial statements.

PCTEL, Inc.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2000	1999
Cash Flows from Operating Activities:		
Net income	\$ 7,897	\$ 4,383
Adjustments to reconcile net income to net cash provided by operating activities:		
Acquired in-process research and development	1,600	-
Depreciation and amortization	4,610	2,029
Amortization of deferred debt costs	-	233
Provision for allowance for doubtful accounts	902	3,915
Provision for excess and obsolete inventories	276	5
Increase in deferred tax asset	-	(634)
Amortization of deferred compensation	997	451
Changes in operating assets and liabilities, net of acquisitions:		
(Increase) decrease in accounts receivable	(11,940)	2,969
(Increase) in inventories	(3,305)	(2,616)
(Increase) decrease in prepaid expenses and other assets	533	(1,230)
(Decrease) increase in accounts payable	492	(932)
Increase in accrued royalties	2,959	1,990
Increase in income taxes payable	960	506
Increase in accrued liabilities	1,429	3,900
Net Cash Provided by Operating Activities	7,410	14,969
Cash Flows from Investing Activities:		
Capital expenditures for property and equipment	(2,563)	(1,251)
Purchase of Voyager Technologies, net of cash acquired	(3,648)	-
Sale (purchase) of available-for-sale investments, net	(1,587)	(7,056)
Net Cash Used in Investing Activities	(7,798)	(8,307)
Cash Flows from Financing Activities:		
Proceeds from issuance of common stock	33,181	163
Costs incurred related to issuance of common stock	(1,010)	(468)
Principal payments on capital lease obligations	-	(24)
Principal payments on notes payable	-	(1,310)
Net Cash Provided by (Used in) Financing Activities	32,171	(1,639)
Net increase in cash and cash equivalents	31,783	5,023
Cash and cash equivalents, beginning of period	44,705	12,988
Cash and cash equivalents, end of period	\$ 76,488	\$ 18,011
	=====	=====

The accompanying notes are an integral part of these consolidated condensed financial statements.

NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2000
(UNAUDITED)

1. BASIS OF PRESENTATION

The condensed financial statements included herein have been prepared by PCTEL, Inc. (the "Company" or "PCTEL"), pursuant to the laws and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the disclosures are adequate to make the information not misleading. The condensed balance sheet as of December 31, 1999 has been derived from the audited financial statements as of that date, but does not include all disclosures required by generally accepted accounting principles. These financial statements and notes should be read in conjunction with the audited financial statements and notes thereto, included in PCTEL's Registration Statement on Form S-1 and annual report on Form 10-K filed with the Securities and Exchange Commission.

The unaudited condensed financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of financial position, results of operations and cash flows for the periods indicated. The results of operations for the three and nine months ended September 30, 2000 are not necessarily indicative of the results that may be expected for future quarters or the year ending December 31, 2000.

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Operations of the Company

PCTEL was originally incorporated in California in February 1994. In July 1998, the Company reincorporated in Delaware and this reincorporation has been reflected retroactively in the accompanying consolidated financial statements.

We are a leading provider of software-based high speed connectivity solutions to individuals and businesses worldwide. We design, develop, produce and market advanced software-based high performance, low cost modems that are flexible and upgradable, with functionality that can include data/fax transmission at various speeds, and telephony features. Our soft modem products consist of a hardware chip set containing a proprietary host signal processing software architecture which allows for the utilization of the computational and processing resources of a host central processor, effectively replacing special-purpose hardware required in conventional hardware-based modems. Together, the combination of the chip set and software drivers are a component part within a computer which allows for telecommunications connectivity. By replacing hardware with a software solution, our host signal processing technology lowers costs while enhancing capabilities.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Consolidation and Foreign Currency Translation

We use the United States dollar for our financial statements, even for our subsidiaries in foreign countries. All gains and losses resulting from transactions originally in foreign currencies and then translated into US dollars are included in net income. As of September 30, 2000, PCTEL had subsidiaries in the Cayman Islands and Japan. These consolidated financial statements include the accounts of PCTEL and our subsidiaries after eliminating intercompany accounts and transactions.

Cash Equivalents and Short-Term Investments

We divide our financial instruments into two different classifications:

Cash equivalents: are debt instruments that mature within three months after we purchase them.

Short-term investments: are marketable debt instruments that generally mature between three months and two years from the date we purchase them. All of our short-term investments are classified as current assets and available-for-sale because they are marketable and we have the option to sell them before they mature.

As of September 30, 2000, short-term investments consisted of high-grade corporate securities with maturity dates of approximately five months to two years.

These investments are recorded at market price and any unrealized holding gains and losses (based on the difference between market price and book value) are reflected as other comprehensive income/loss in the stockholders' equity section of the balance sheet. We have accumulated a \$28,000 unrealized holding loss as of September 30, 2000. Realized gains and losses and declines in value of securities judged to be other than temporary are included in interest income and have not been significant to date. Interest and dividends of all securities are included in interest income.

Inventories

Inventories are stated at the lower of cost or market and include material, labor and overhead costs. Inventories as of September 30, 2000 and December 31, 1999 were composed of finished goods only. Based on our current estimated requirements, it was determined that there was excess inventory and those excess amounts were fully reserved as of September 30, 2000 and December 31, 1999. Due to competitive pressures and technological innovation, it is possible that these estimates could change in the near term.

Revenue Recognition

Revenues consist primarily of sales of products to original equipment manufacturers ("OEMs") and distributors. Revenues from sales to OEMs are recognized upon shipment. We provide for estimated sales returns and rebate allowances related to sales to OEMs at the time of shipment. Revenues from sales to distributors are made under agreements allowing price protection and rights of return on unsold products. We record revenue relating to sales to distributors only when the distributors have sold the product to end users. Customer payment terms generally range from letters of credit collectible upon shipment to open account payable 60 days after shipment.

We also generate revenues from engineering contracts. Revenues from engineering contracts are recognized as contract milestones are achieved. Royalty revenue is recognized when confirmation of royalties due to PCTEL is received from licensees. Furthermore, revenues from technology licenses are recognized after delivery has occurred and the amount is fixed and determinable, generally based upon the contract's nonrefundable payment terms. To the extent there are extended payment terms on these contracts, revenue is recognized as the payments become due and the cancellation privilege lapses. To date, the Company has not offered post-contract customer support.

Earnings Per Share

We compute earnings per share in accordance with SFAS No. 128, "Earnings Per Share". SFAS No. 128 requires companies to compute net income per share under two different methods, basic and diluted, and present per share data for all periods in which a statement of operations is presented. Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of common stock and common stock equivalents outstanding. Common stock equivalents consist of preferred stock using the "if converted" method and stock options and warrants using the treasury stock method. Preferred stock, common stock options and warrants are excluded from the computation of diluted earnings per share if their effect is anti-dilutive.

Based on SEC Staff Accounting Bulletin No. 98, preferred and common stock issued or granted for below fair market value (nominal consideration) prior to the IPO must be included in the earnings per share calculation as if they had been outstanding the entire period. We have never issued or granted this type of stock.

The following table provides a reconciliation of the numerators and denominators used in calculating basic and diluted earning per share for the three and nine months ended September 30, 2000 and 1999, respectively (in thousands, except per share information):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2000	1999	2000	1999
	(Unaudited)		(Unaudited)	
Net income	\$ 3,378	\$ 1,679	\$ 7,897	\$ 4,383
	=====	=====	=====	=====
Basic earnings per share:				
Weighted average common shares outstanding	18,441	2,512	17,745	2,462
	-----	-----	-----	-----
Basic earnings per share	\$ 0.18	\$ 0.67	\$ 0.45	\$ 1.78
	=====	=====	=====	=====
Diluted earnings per share:				
Weighted average common shares outstanding	18,441	2,513	17,745	2,462
Weighted average common stock option grants and outstanding warrants	2,120	2,414	2,893	1,885
Weighted average preferred stock outstanding	-	8,511	-	8,511
	-----	-----	-----	-----
Weighted average common shares and common stock equivalents outstanding	20,561	13,438	20,638	12,858
	-----	-----	-----	-----
Diluted earnings per share	\$ 0.16	\$ 0.12	\$ 0.38	\$ 0.34
	=====	=====	=====	=====

Industry Segment, Customer and Geographic Information

We are organized based upon the nature of the products we offer. Under this organizational structure, we operate in one segment, that segment being software-based modems using host signal processing technology. We market our products worldwide through our sales personnel, independent sales representatives and distributors.

Our sales to customers outside of the United States, as a percentage of revenues are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2000	1999	2000	1999
	(Unaudited)		(Unaudited)	
Taiwan	50%	22%	53%	28%
China (Hong Kong)	32	74	35	51
Rest of Asia	4	3	4	19
	-----	-----	-----	-----
	86%	99%	92%	98%
	=====	=====	=====	=====

Sales to our major customers representing greater than 10% of revenues are as follows:

Customer -----	Three Months Ended September 30,		Nine Months Ended September 30,	
	2000	1999	2000	1999
	(Unaudited)		(Unaudited)	
A	16%	12%	13%	9%
B	8%	--%	11%	--%
C	32%	65%	33%	51%

Our customers are concentrated in the personal computer industry and modem board manufacturer industry segment and in certain geographic locations. We actively market and sell products in Asia. We perform ongoing evaluations of our customers' financial condition and generally require no collateral. As of September 30, 2000, approximately 73% of gross accounts receivable were concentrated with five customers. As of September 30, 1999, approximately 82% of gross accounts receivable were concentrated with five customers.

Recent Accounting Pronouncements

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition". In June 2000, the SEC deferred the adoption date for SAB 101 until our fourth quarter ended December 31, 2000. SAB 101 summarizes certain areas of the Staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. The Company has not quantified the effect of SAB 101 on its financial position or results of operations and has not yet determined the timing and method of adoption.

In March 2000, the FASB issued Financial Standards Board Interpretation (FIN) No. 44, "Accounting for Certain Transactions Involving Stock Compensation--an Interpretation of APB Opinion No. 25." FIN 44 addresses the application of APB 25 to clarify, among other issues, (a) the definition of employee for purposes of applying APB 25, (b) the criteria for determining whether a plan qualifies as a noncompensatory plan, (c) the accounting consequence of various modifications to the terms of a previously fixed stock option or award, and (d) the accounting for an exchange of stock compensation awards in a business combination. FIN 44 is effective July 1, 2000, but certain conclusions cover specific events that occur after either December 15, 1998 or January 12, 2000. To the extent FIN 44 covers events occurring during the period after December 15, 1998 or January 12, 2000, but before the effective date of July 1, 2000, the effects of applying the interpretation will be recognized on a prospective basis from July 1, 2000. The Company adopted FIN 44 in July 2000 and this adoption did not have a material effect on its financial position or results of operations.

3. ACQUISITIONS:

Voyager Technologies, Inc.

On February 24, 2000, we completed the acquisition of Voyager Technologies, Inc., ("Voyager"), a provider of personal connectivity and internet access technology. Under the terms of the Agreement and Plan of Reorganization (the "Merger Agreement"), the former shareholders of Voyager received 237,272 shares of our common stock and \$2,065,331 of cash in exchange for all shares of Voyager common stock. In addition, 645,157 vested and unvested options to purchase shares of Voyager common stock were converted into 49,056 options to purchase our common stock at the exchange ratio of 0.07604. Included in the 237,272 shares are 82,419 restricted shares of common stock issued to a Voyager shareholder. These shares are not subject to forfeiture under any circumstances and, thus, were considered in the determination of the purchase price at the date of acquisition.

The purchase price of Voyager was allocated based upon the estimated fair value of the assets acquired and liabilities assumed, which approximated book value. The following table summarizes the components of the total purchase price and the allocation (in thousands, except share amounts).

Fair value of 237,272 shares of our common stock	\$	11,802
Fair value of options for 49,056 shares of our common stock		2,504
Cash		2,065
Settlement of outstanding claim		1,500
Acquisition costs		699

Estimated total purchase price		18,570
Less: Net assets acquired		(762)

Estimated acquired intangibles	\$	17,808
		=====

The acquisition was structured as a tax-free reorganization and was accounted for under the purchase method of accounting. Under this method, if the purchase price exceeds the net tangible assets acquired, the difference is recorded as excess purchase price. In this circumstance, the difference was \$17.8 million. We attributed \$1.6 million of the excess purchase price to in-process research and development, which we expensed immediately, and the balance of \$16.2 million was attributed to intellectual property (\$0.5 million), workforce (\$0.3 million) and goodwill (\$15.4 million). We have classified this balance of \$16.2 million as goodwill and other intangible assets, net, in the accompanying consolidated balance sheets and are amortizing it over useful lives of five years. We have included the results of Voyager from the date of acquisition to September 30, 2000 in the consolidated condensed statements of operations.

In addition to the 237,272 shares of our common stock issued to the shareholders of Voyager, 30,415 additional shares of common stock were held in an escrow account pending resolution of an outstanding claim. These shares had been treated as contingent consideration and were not initially recognized as purchase price due to the uncertainty of how the claim would be resolved. In May 2000, the outstanding claim was settled for \$1.5 million which resulted in the return of the stock held in escrow to the Company. No amount was initially recorded for the now-unissued stock while in escrow, however, the \$1.5 million outstanding claim settlement was recognized as additional purchase price in the quarter ended June 30, 2000.

As part of the acquisition, we granted 49,056 vested and unvested options to purchase our common stock upon conversion of the outstanding Voyager options, based on the exchange ratio of 0.07604. The fair value of these options was determined using the Black-Scholes option pricing model and the following assumptions: risk-free interest rate of 5.50%; dividend yields of zero; an estimated volatility factor of the market price of the our common stock of 75%; and an expected life between three to six months after vest date. The weighted-average estimated fair value of these options was \$51.05 per share.

In addition, total estimated acquisition costs were \$699,000, as reflected in the above table.

Upon completion of the Voyager acquisition, we immediately expensed \$1.6 million representing purchased in-process technology that had not yet reached technological feasibility and had no alternative future use. The \$1.6 million expensed as in-process research and development was approximately 9% of the purchase price and was attributed and supported by a discounted cash flow analysis that identified revenue and costs on a project by project basis. The value assigned to purchased in-process technology, based on a percentage of completion discounted cash flow method, was determined by identifying research projects in areas for which technological feasibility has not been established. The following in-process projects existed at Voyager as of the acquisition date: Bluetooth, HomeRF, Direct Sequence Cordless, Bluetooth/HomeRF Combo, Bluetooth/HomeRF/Direct Sequence, Wireless Gas Tank Sensor, Wireless GPS and Wireless Industrial Garage Door Opener projects.

The value of in-process research and development was determined by estimating the costs to develop the purchased in-process technology into commercially viable products, estimating the resulting net cash flows from such projects and discounting the net cash flows back to their present value. The discount rate includes a risk adjusted discount rate to take into account the uncertainty surrounding the successful development of the purchased in-process technology. The risk-adjusted discount rate applied to the projects' cash flows was 15% for existing technology and 20% for the in-process technology. Based upon assessment of each in-process project's development stage, including relative difficulty of remaining development milestones, it was determined that application of a 20% discount rate was appropriate for all acquired in-process projects. The valuation includes cash inflows from in-process technology through 2005 with revenues commencing in 2000 and increasing significantly in 2001 before declining in 2005. The projected total revenue of Voyager was broken down to revenue attributable to the in-process technologies, existing technologies, core technology and future technology. The revenue attributable to core technology was determined based on the extent to which the in-process technologies rely on the already developed

intellectual property. The Bluetooth and HomeRF projects were approximately 25% complete at the time of the valuation and the expected timeframe for achieving these product releases was assumed to be in the second half of 2000. The Direct Sequence Cordless project was approximately 65% complete at the time of the valuation and the expected time frame for achieving this product release was assumed to be in the second half of 2000. The Bluetooth/HomeRF Combo and Bluetooth/HomeRF/Direct Sequence projects were approximately 10% complete at the time of the valuation and the expected timeframe for achieving these product releases was assumed to be in the second half of 2000 and the first half of 2000, respectively. The Wireless Gas Tank Sensor and the Wireless Industrial Garage Door Opener projects were approximately 70% complete at the time of the valuation and the expected time frame for achieving these product releases was assumed to be 2001. The Wireless GPS was approximately 50% complete at the time of the valuation and the expected time frame for achieving this product release was assumed to be in the second half of 2000. The percentage complete calculations for all projects were estimated based on research and development expenses incurred to date and management estimates of remaining development costs. Significant remaining development efforts must be completed in the next 6 to 18 months in order for Voyager's projects to become implemented in a commercially viable timeframe. Management's cash flow and other assumptions utilized at the time of acquisition do not materially differ from historical pricing/licensing, margin, and expense levels of the Voyager group prior to acquisition.

Approximately \$0.5 million was attributed to core wireless technology and royalty revenue associated with the Wireless Water Meter Reading Device project.

If these projects are not successfully developed, our future revenue and profitability may be adversely affected. Additionally, the value of other intangible assets acquired may become impaired.

The unaudited pro forma financial information for the nine months ended September 30, 2000 and 1999 is presented below (in thousands except per share information) as if Voyager had been acquired on January 1. Pro forma net income excludes the write-off of acquired in-process research and development of \$1.6 million.

	Nine Months Ended September 30,	
	2000	1999
Revenues	\$ 80,700	\$ 54,108
Net income	\$ 9,502	\$ 4,605
Diluted net income per share	\$ 0.46	\$ 0.36

4. CONTINGENCIES:

As of September 30, 2000 and December 31, 1999, we had accrued royalties of approximately \$10.8 million and \$7.9 million, respectively. We entered into royalty agreements in fiscal 1999 and 1998 and continue to negotiate royalty agreements with several other third parties. Accordingly, we have accrued our best estimate of the amount of royalties payable based on royalty agreements already signed or in negotiation, as well as advice from third party technology advisors. Should the final agreements result in royalty rates significantly different from these assumptions, our business, operating results and financial condition could be materially and adversely affected.

During 1998, Motorola, Inc. ("Motorola") filed an action for patent infringement against us (and one other defendant) related to seven Motorola patents. In its complaint, Motorola was seeking damages for our alleged infringement, including treble damages for our alleged willful infringement and an injunction against us. Motorola was also seeking attorney's fees and costs.

We filed an answer to Motorola's complaint denying infringement of the seven asserted Motorola patents and asserted that each patent is invalid or unenforceable. In addition, we asserted counterclaims and declaratory relief for invalidity and/or unenforceability and noninfringements of each of the seven asserted Motorola patents. By our counterclaims, we were seeking compensatory and punitive damages, an injunction against Motorola, and an award of treble damages for Motorola's violation of the Federal and state antitrust laws, and for violation of Massachusetts General Law. We were also seeking our costs and attorney's fees in this action. In September 1999, we reached a settlement with Motorola as to all claims raised by both parties. The settlement requires us to make royalty payments to Motorola based on unit volume. As part of the settlement, we granted a cross-license to Motorola to utilize

portions of our technology and Motorola granted us a cross-license to utilize portions of their technology. This settlement did not have a material effect on our financial position or operating results.

On April 9, 1999, ESS Technology Inc. filed a complaint against us in the U.S. District Court for the Northern District of California, alleging that we failed to grant licenses for some of our International Telecommunications Union-related patents to ESS on fair, reasonable and non-discriminatory terms. ESS's complaint includes claims based on antitrust law, patent misuse, breach of contract and unfair competition. In its complaint, ESS also seeks a declaration that some of our International Telecommunications Union-related patents are unenforceable and that we should be ordered by the court to grant a license to ESS on fair, reasonable and non-discriminatory terms.

We filed an answer to ESS's complaint by moving to dismiss on the basis that ESS had not alleged facts sufficient to state a legal claim. ESS responded by amending its complaint to include additional factual and legal allegations and filing an opposition to the motion to dismiss. On August 2, 1999, the Court denied our motion to dismiss as moot in view of ESS's amended complaint.

On August 12, 1999, we filed a motion to dismiss ESS's amended complaint. On November 4, 1999, the United States District Court in San Jose, California, granted a dismissal of the antitrust and state unfair competition claims, ruling that ESS had failed to allege injury to competition in the market for modems. The Court allowed the specific performance of contract claim to stand, ruling that the license terms granted to other market participants would provide a sufficient basis for defining contractual terms that could be applied to ESS. The Court also denied the motion with respect to dismissal of the declaratory relief claims, holding that they were sufficiently ripe for adjudication. The Court granted ESS leave to again amend its complaint, which it did on November 24, 1999, by filing a second amended complaint. On January 14, 2000, we filed a motion to dismiss the second amended complaint. ESS filed its opposition to the motion on January 21, 2000 and we filed our reply on January 28, 2000. On February 11, 2000, the Court heard oral argument on our motion to dismiss the second amended complaint. On February 14, 2000, the Court dismissed ESS's complaint and gave ESS twenty days to amend its complaint. In particular, the Court stated that ESS must allege the relevant geographic market and product market in the complaint. In response to the Court's February 14, 2000 order, ESS filed its third amended complaint on March 6, 2000.

On March 15, 2000, we filed a motion to dismiss ESS's third amended complaint. ESS responded on March 31, 2000 and we filed reply papers on April 6, 2000. A case management conference was held on April 21, 2000. The motion was denied on July 3, 2000. The judge ordered that discovery proceed only on the issue of whether we license our patents on a reasonable and non-discriminatory basis. This initial discovery period is scheduled to end on April 13, 2001, pursuant to a stipulation and order in the case. During this period of time, the parties will disclose experts and exchange expert reports on the above issue. A case management conference is scheduled to be held on April 20, 2001.

On August 7, 2000, PCTEL filed counterclaims alleging that ESS infringes the five PCTEL patents that are the subject of ESS's complaint. In addition, on October 3, 2000, the parties stipulated to permit us to amend our counterclaims to include claims that ESS infringes three additional PCTEL patents. Our eight patent infringement claims will be litigated, if necessary, only after the issue of whether we license our patents on a reasonable and non-discriminatory basis is resolved.

Due to the nature of litigation generally and because the lawsuit brought by ESS is still in the pleading stage, we cannot ascertain the outcome of the final resolution of the lawsuit, the availability of injunctive relief or other equitable remedies, or estimate the total expenses, possible damages or settlement value, if any, that we may ultimately incur in connection with ESS's suit. This litigation could be time consuming and costly, and we will not necessarily prevail given the inherent uncertainties of litigation. However, we believe that we have valid defenses to this litigation, including the fact that other companies license these International Telecommunications Union-related patents from us on the same terms that are being challenged by ESS. We believe that it is unlikely this litigation will have a material adverse effect on our financial position or results of operations. We are vigorously contesting, and intend to continue to vigorously contest, all of ESS's claims.

On August 9, 2000, we filed a complaint for patent infringement in the United States District Court, District of Delaware against Smart Link Ltd. and Smart Link Technologies, Inc. (collectively, "Smart Link"). Our complaint alleges that Smart Link infringed four of our patents. On August 18, 2000, we amended our complaint to claim that Smart Link's infringement was willful.

On September 18, 2000, Smart Link answered our amended complaint and counterclaimed against us. Smart Link's answer denied our allegations of infringement. Smart Link's counterclaims seek declaratory relief that the asserted PCTEL patents are invalid and not infringed. Smart Link also counterclaims for tortious interference with a business relation. On October 10, 2000, we replied to Smart Link's counterclaims and moved to strike portions of Smart Link's answer.

On August 25, 2000, Smart Link Ltd. filed a complaint in the United States District Court, District of Massachusetts. Smart Link Ltd.'s complaint alleges that we infringe two of Smart Link Ltd.'s patents. On October 11, 2000, we answered Smart Link Ltd.'s complaint and counterclaimed against Smart Link Ltd. and Smart Link Technologies, Inc. Our answer denies Smart Link Ltd.'s allegations of infringement. Our counterclaims seek declaratory relief that the asserted Smart Link patents are invalid and not infringed. Our counterclaims also allege that Smart Link infringes one of our patents.

Due to the nature of litigation generally and because the lawsuits brought by Smart Link are still in the pleading stage, we cannot ascertain the outcome of the final resolution of the lawsuits, the availability of injunctive relief or other equitable remedies, or estimate the total expenses, possible damages or settlement value, if any, that we may ultimately incur in connection with Smart Link's lawsuits. These litigations could be time consuming and costly, and we will not necessarily prevail given the inherent uncertainties of litigations. We believe that it is unlikely these litigations will have a material adverse effect on our financial position or results of operations. We are vigorously contesting, and intend to continue to vigorously contest, all of Smart Link's claims.

On September 14, 2000, we filed a complaint Under Section 337 of the Tariff Act of 1930, as Amended with the United States International Trade Commission ("ITC"). Our complaint requested that the ITC commence an investigation into whether Smart Link and ESS are engaged in unfair trade practices by selling for importation into the United States, directly or indirectly importing into the United States, or selling in the United States after importation devices which infringe our patents. Four of our patents are asserted against Smart Link and two of those four patents are asserted against ESS. A supplemental complaint was filed on October 3, 2000.

On October 11, 2000, the ITC voted to institute an investigation into our complaint. On October 18, 2000, notice of the ITC investigation was published in the Federal Register. ESS responded to our complaint on October 31, 2000. Smart Link has until November 7, 2000 to respond to our complaint. Discovery is currently underway. By order of the administrative law judge, the ITC investigation is to be completed by December 18, 2001.

We are contesting the case vigorously and intend to continue to do so. We are not able to predict the outcome of this matter.

PCTEL is subject to various claims which arise in the normal course of business. In the opinion of management, the ultimate disposition of these claims will not have a material adverse effect on our financial position, liquidity or results of operations.

5. AMORTIZATION OF DEFERRED COMPENSATION:

In connection with the grant of stock options to employees prior to our initial public offering, we have recorded deferred compensation representing the difference between the exercise price and deemed fair market value of our common stock on the date these stock options were issued.

For the quarters and nine months ended September 30, 2000 and 1999, amortization of deferred compensation (in thousands) relates to the following functional categories:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2000	1999	2000	1999
Research and development	\$ 70	\$ 79	\$ 222	\$ 143
Sales and marketing	73	79	229	154
General and administrative	177	129	546	154
	\$ 370	\$ 287	\$ 997	\$ 451
	=====	=====	=====	=====

6. COMMON STOCK

On April 11, 2000, the Company effected its secondary public offering of common stock. A total of 2,750,000 shares were sold at a price of \$46.50 per share; 650,000 shares were sold by the Company and 2,100,000 shares were sold by selling stockholders of the Company. The offering resulted in net proceeds to the Company and the selling stockholders of approximately \$27.9 million and \$92.8 million, respectively, net of an underwriting discount of \$6.4 million and estimated offering expenses of \$0.8 million.

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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The following information should be read in conjunction with the condensed interim financial statements and the notes thereto included in Item 1 of this Quarterly Report and with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in PCTEL's Prospectus filed with the Securities and Exchange Commission on April 11, 2000. Certain statements contained in this Quarterly Report on Form 10-Q, including, without limitation, statements containing the words "believes", "anticipates", "estimates", "expects", and words of similar import, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described below and elsewhere in this Quarterly Report, and in other documents we file with the SEC.

Overview

We provide cost-effective software-based communications solutions that address high speed internet connectivity requirements for existing and emerging technologies. Our communications products enable internet access through PCs and alternative internet access devices. Our soft modem products consist of a hardware chip set containing a proprietary host signal processing software architecture which allows for the utilization of the computational and processing resources of a host central processor, effectively replacing special-purpose hardware required in conventional hardware-based modems. Together, the combination of the chip set and software drivers are a component part within a computer which allows for telecommunications connectivity. By replacing hardware with a software solution, our host signal processing technology lowers costs while enhancing capabilities.

From our inception in February 1994 through the end of 1995, we were a development stage company primarily engaged in product development, product testing and the establishment of strategic relationships with customers and suppliers. From December 31, 1995 to September 30, 2000, our total headcount increased from 18 to 188. We first recognized revenue on product sales in the fourth quarter of 1995, and became profitable in 1996, our first full year of product shipments. Revenues increased from \$16.6 million in 1996 to \$24.0 million in 1997, \$33.0 million in 1998 and \$76.3 million in 1999. Revenues for the nine months ended September 30, 2000 were \$80.5 million.

We sell soft modems to manufacturers and distributors principally in Asia through our sales personnel, independent sales representatives and distributors. Our sales to manufacturers and distributors in Asia were 99%, 76% and 77% of our total sales for the years ended 1999, 1998 and 1997, respectively, 92% and 98% for the nine months ended September 30, 2000 and 1999, respectively, and 86% and 99% for the three months ended September 30, 2000 and 1999, respectively. The predominance of our sales is in Asia because our customers are primarily motherboard and modem manufacturers, and the majority of these manufacturers are located in Asia. In many cases, our indirect original equipment manufacturer customers specify that our products be included on the modem boards or motherboards that they purchase from the board manufacturers, and we sell our products directly to the board manufacturers for resale to our indirect original equipment manufacturer customers, both in the United States and internationally. Industry statistics indicate that approximately two-thirds of modems manufactured in Asia are sold in North America.

We recognize revenues from product sales to customers upon shipment, except sales to distributors which are recognized only when distributors have sold the product to the end user. We provide for estimated sales returns and rebate allowances related to sales to OEMs at the time of shipment. We recognize revenues from non-recurring engineering contracts as contract milestones are achieved. Revenues from technology licenses are recognized after delivery has occurred and the amount is fixed and determinable, generally based upon the contract's nonrefundable payment terms. To the extent there are extended payment terms on these contracts, revenue is recognized as the payments become due and the cancellation privilege lapses. To date, the Company has not offered post-contract customer support. Customer payment terms generally range from letters of credit collectible upon shipment to open account payable 60 days after shipment.

Results of Operations

Three and nine months ended September 30, 2000 and 1999 (All amounts in tables are in thousands, except percentages)

Revenues

	Three Months Ended September 30, 2000	Three Months Ended September 30, 1999	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
Revenues.....	\$ 28,885	\$ 20,190	\$ 80,529	\$ 53,236
% change from year ago period.....	43.1%		51.3%	

Our revenues primarily consist of product sales of soft modems to board manufacturers and distributors in Asia. Revenues increased \$8.7 million for the three months ended September 30, 2000 compared to the same period in 1999. Revenues for the nine months ended September 30, 2000 increased \$27.3 million compared to the same period in 1999. These increases were attributable to increased units sold to tier-one OEMs such as Compaq Corporation, Intel Corporation, Fujitsu Limited and NEC Corporation and to a lesser extent, increased license revenues recognized in the three months ended September 30, 2000. The increase in sales volume was partly offset by downward pressure on average selling prices and sales discounts to customers. Our average selling prices decreased from September 30, 1999 to September 30, 2000, mainly due to the downward pricing pressure which is commonly seen in the industry. However, we believe this decrease in selling prices has generated the increase in sales volume.

Gross Profit

	Three Months Ended September 30, 2000	Three Months Ended September 30, 1999	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
Gross profit.....	\$ 13,571	\$ 9,750	\$ 37,851	\$ 25,799
Percentage of revenues.....	47.0%	48.3%	47.0%	48.5%
% change from year ago period.....	39.2%		46.7%	

Cost of revenues consists primarily of chip sets we purchase from third party manufacturers and also includes amortization of intangibles related to the Communications Systems Division acquisition, accrued intellectual property royalties, cost of operations, provision for inventory obsolescence and distribution costs.

Gross profit increased \$3.8 million for the three months ended September 30, 2000 compared to the same period last year due to increased volume, partially offset by a decline in the per-unit average gross profit. Gross profit as a percentage of revenue decreased from 48.3% for the three months ended September 30, 1999 to 47.0% for the three months ended September 30, 2000 because of a shift to higher volume, lower margin sales to OEMs and, generally, average selling prices decreased faster than the rate of cost reductions. On the other hand, higher-margin license revenues favorably impacted gross margins during the quarter, partially offsetting the decrease from average selling prices.

Gross profit increased \$12.1 million for the nine months ended September 30, 2000 over the same period in 1999 but decreased as a percentage of revenue from 48.5% to 47.0% for primarily the same reasons discussed above.

Research and Development

	Three Months Ended September 30, 2000	Three Months Ended September 30, 1999	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
Research and development.....	\$ 3,900	\$ 2,732	\$ 11,609	\$ 7,155
Percentage of revenues.....	13.5%	13.5%	14.4%	13.4%
% change from year ago period.....	42.8%		62.3%	

Research and development expenses include compensation costs for software and hardware development, prototyping, certification and pre-production costs. We expense all research and development costs as incurred.

Research and development expenses increased \$1.2 million for the three months ended September 30, 2000 compared to the same period in 1999 as we continue to invest heavily in the development of the G.Lite, G.DMT, wireless and embedded modems, as well as a V.92 upgrade. Research and development headcount increased from 64 to 73 from September 30, 1999 to September 30, 2000. As a percentage of revenues, research and development expenses remained at the same level for the three months ended September 30, 2000 compared to the same period in 1999.

Research and development expenses increased \$4.5 million for the nine months ended September 30, 2000 compared to the same period in 1999 for the same reasons discussed above. Approximately 66% of all research and development expenses are payroll related. We expect that our research and development expenses will increase because we intend to hire additional personnel and continue to develop new products, although our research and development expenses as a percentage of revenues is expected to decrease as our revenues are expected to increase at a greater rate than our expenses.

Sales and Marketing

	Three Months Ended September 30, 2000	Three Months Ended September 30, 1999	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
Sales and marketing.....	\$ 3,660	\$ 2,609	\$ 10,385	\$ 7,554
Percentage of revenues.....	12.7%	12.9%	12.9%	14.2%
% change from year ago period.....	40.3%		37.5%	

Sales and marketing expenses consist primarily of personnel costs, sales commissions and marketing costs. Sales commissions payable to our distributors are recognized when our products are "sold through" from the distributors to end users so that the commission expense is matched with related recognition of revenues. Marketing costs include promotional goods, public relations and trade shows.

Sales and marketing expenses increased \$1.1 million but decreased slightly as a percentage of revenues for the three months ended September 30, 2000 compared to the same period in 1999. The increase reflects the increased costs to support higher sales and the addition of sales and marketing personnel to develop new accounts and drive new product development and product launches. Sales and marketing headcount increased from 48 to 65 from September 30, 1999 to 2000. The production of collateral sales materials, travel costs, public relation costs, trade shows, sales programs and press tours also increased from a year ago.

Sales and marketing expenses increased \$2.8 million but decreased as a percentage of revenues for the nine months ended September 30, 2000 compared to the same period in the prior year. The increase in expenses is due to the increase in headcount, as well as the production of collateral sales materials, additional travel costs, public relation costs, trade shows, sales programs and press tour.

General and Administrative

	Three Months Ended September 30, 2000	Three Months Ended September 30, 1999	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
General and administrative.....	\$ 2,191	\$ 1,571	\$ 5,669	\$ 3,634
Percentage of revenues.....	7.6%	7.8%	7.0%	6.8%
% change from year ago period.....	39.4%		56.0%	

General and administrative expenses include costs associated with our general management and finance functions as well as professional service charges, such as legal, tax and accounting fees. Other general expenses

include rent, insurance, utilities, travel and other operating expenses to the extent not otherwise allocated to other functions.

General and administrative expenses increased \$620,000 for the three months ended September 30, 2000 compared to the same period in 1999 and \$2.0 million for the nine months ended September 30, 2000 compared to the same period in 1999. The increase was primarily due to our increase in staffing and related infrastructure to support our continued growth and the increased legal costs associated with the patent infringement litigation against Smart Link and ESS. As a percentage of revenues, general and administrative expenses remained approximately at the same level for the three and nine months ended September 30, 2000 compared to the same periods in 1999. General and administrative headcount increased from 17 to 32 from September 30, 1999 to September 30, 2000.

Acquired In-Process Research and Development

	Three Months Ended September 30, 2000	Three Months Ended September 30, 1999	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
Acquired in-process research and development	\$ --	\$ --	\$ 1,600	\$ --
Percentage of revenues.....	-- %	-- %	2.0%	-- %

As explained in Note 3 of the consolidated condensed financial statements, on February 24, 2000, we completed the acquisition of Voyager Technologies, Inc., ("Voyager"), a provider of personal connectivity and internet access technology. It was determined that \$1.6 million of the purchase price was related to in-process research and development, which was immediately expensed in the first quarter of 2000.

Amortization of Deferred Compensation

	Three Months Ended September 30, 2000	Three Months Ended September 30, 1999	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
Amortization of deferred compensation	\$ 320	\$ 287	\$ 997	\$ 451
Percentage of revenues.....	1.1%	1.4%	1.2%	0.8%
% change from year ago period.....	11.5%		121.1%	

In connection with the grant of stock options to employees prior to our initial public offering, we have recorded deferred compensation representing the difference between the exercise price and deemed fair market value of our common stock on the date these stock options were issued.

The amortization of deferred compensation increased \$33,000 for the three months ended September 30, 2000 compared to the same period in 1999 primarily due to a higher deemed fair market value of our stock and additional stock options granted to new employees prior to the initial public offering.

The amortization of deferred compensation increased \$546,000 for the nine months ended September 30, 2000 compared to the same period in 1999 for the reasons discussed above. We expect that the amortization of deferred compensation to remain at approximately \$320,000 per quarter through the third quarter of 2003.

Other Income, Net

	Three Months Ended September 30, 2000	Three Months Ended September 30, 1999	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
Other income (expense), net.....	\$ 2,008	\$ (155)	\$ 5,166	\$ (747)
Percentage of revenues.....	7.0%	(0.8)%	6.4%	(1.4)%
% change from year ago period.....	N/A		N/A	

Other income, net, consists of interest income, net of interest expense. Interest income is expected to fluctuate over time. Other income, net, increased \$2.2 million for the three months ended September 30, 2000 compared to the same period in 1999 primarily due to interest earned from the proceeds from the initial public offering and secondary public offering proceeds and the elimination of interest expense on the loan that we used to acquire Communications Systems Division.

Other income, net, increased \$5.9 million for the nine months ended September 30, 2000 compared to the same period in 1999 primarily for the same reasons discussed above.

Provision for Income Taxes

	Three Months Ended September 30, 2000	Three Months Ended September 30, 1999	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
Provision for income taxes.....	\$ 1,319	\$ 717	\$ 3,033	\$ 1,875
Effective tax rate.....	28.1%	30.0%	27.7%	30.0%

Provision for income taxes increased for the three months ended September 30, 2000 over the same period in 1999 due to higher taxable income. The effective tax rate decreased from 30.0% a year ago to 28.1%

We have \$5.8 million in deferred tax assets as of September 30, 2000. We believe that our effective tax rate will continue to be below the statutory tax rate of 35% due to international sales and profits through our wholly owned subsidiaries, which are taxed at rates below the statutory tax rate in the U.S.

Liquidity and Capital Resources

	Nine Months Ended September 30, 2000	Nine Months Ended September 30, 1999
Net cash provided by operating activities.....	\$ 7,410	\$ 14,969
Net cash used in investing activities.....	\$ (7,798)	\$ (8,307)
Net cash provided by (used in) financing activities.....	\$ 32,171	\$ (1,639)
Cash, cash equivalents and short-term investments at the end of period.....	\$ 131,699	\$ 25,067
Working capital at the end of period.....	\$ 131,029	\$ 16,827

For the nine months ended September 30, 2000, net cash provided by operating activities was \$7.4 million. Net cash used in investing activities for the nine months ended September 30, 2000 consists of the acquisition of Voyager Technologies, purchases of property and equipment and purchase of short-term investments. Net cash provided by financing activities for the nine months ended September 30, 2000 consisted of proceeds from issuance of common stock associated with the secondary public offering and proceeds from stock option exercises and shares issued through the employee stock purchase plan.

As of September 30, 2000, we had \$131.7 million in cash, cash equivalents and short-term investments, and working capital of \$131.0 million.

Accounts receivable, as measured in days sales outstanding ("DSO"), were 57 days at September 30, 2000 compared to 26 days at December 31, 1999. Collection terms on our sales to tier one customers are generally due 60 days after shipment, which is standard for our industry. As sales to tier one customers increase, we expect DSO to increase as compared to prior periods where sales to smaller customers with payment terms of 45 days or less were proportionately greater. However, DSO at December 31, 1999 was abnormally low primarily due to increased cash collection efforts prior to the year-end holiday period, partially offset by the increase in sales to tier one customers.

We believe that our existing sources of liquidity will be sufficient to meet our working capital and anticipated capital expenditure requirements for at least the next 12 months. Thereafter, we may require additional funds to support our working capital requirements or for other purposes, and we may seek, even before that time, to raise additional funds through public or private equity or debt financing or from other sources. Additional financing may not be available at all, and if it is available, the financing may not be obtainable on terms acceptable to us or that are not dilutive to our stockholders.

Factors Affecting Operating Results

This quarterly report on Form 10-Q contains forward-looking statements which involve risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking statements as a result of certain factors including those set forth below.

Risks Related to Our Business

Our sales are concentrated among a limited number of customers and the loss of one or more of these customers could cause our revenues to decrease.

Our sales are concentrated among a limited number of customers. If we were to lose one or more of these customers, or if one or more of these customers were to delay or reduce purchases of our products, our sales revenues may decrease. For the nine months ended September 30, 2000, approximately 71% of our revenues were generated by five of our customers with one customer representing 33% of revenues. These customers may in the future decide not to purchase our products at all, purchase fewer products than they did in the past or alter their purchasing patterns, because:

- . we do not have any long-term purchase arrangements or contracts with these or any of our other customers,
- . our product sales to date have been made primarily on a purchase order basis, which permit our customers to cancel, change or delay product purchase commitments with little or no notice and without penalty, and
- . many of our customers also have pre-existing relationships with current or potential competitors which may affect our customers' purchasing decisions.

We expect that a small number of customers will continue to account for a substantial portion of our revenues for at least the next 12 to 18 months and that a significant portion of our sales will continue to be made on the basis of purchase orders.

We have significant sales and operations concentrated in Asia. Continued political and economic instability in Asia and difficulty in collecting accounts receivable may make it difficult for us to maintain or increase market demand for our products.

Our sales to customers located in Asia accounted for 92% of our total revenues for the nine months ended September 30, 2000. The predominance of our sales is in Asia, mostly in Taiwan and China, because our customers are primarily motherboard or modem manufacturers that are located there. In many cases, our indirect original equipment manufacturer customers specify that our products be included on the modem boards or motherboards, the main printed circuit board containing the central processing unit of a computer system, that they purchase from board manufacturers, and we sell our products directly to the board manufacturers for resale to our indirect original equipment manufacturer customers, both in the United States and internationally. Due to the industry wide concentration of modem manufacturers in Asia, we believe that a high percentage of our future sales will continue to be concentrated with Asian customers. As a result, our future operating results could be uniquely affected by a variety of factors outside of our control, including:

- . political and economic instability,
- . changes in tariffs, quotas, import restrictions and other trade barriers which may make our products more expensive compared to our competitors' products,
- . delays in collecting accounts receivable, which we have experienced from time to time, and
- . fluctuations in the value of Asian currencies relative to the U.S. dollar, which may make it more costly for us to do business in Asia which may in turn make it difficult for us to maintain or increase our revenues.

To successfully expand our sales in Asia and internationally, we must strengthen foreign operations, hire additional personnel and recruit additional international distributors and resellers. This will require significant management attention and financial resources. To the extent that we are unable to effect these additions in a timely

manner, we may not be able to maintain or increase market demand for our products in Asia and internationally, and our operating results could be hurt.

Continuing decreases in the average selling prices of our products could result in decreased revenues.

Product sales in the connectivity industry have been characterized by continuing erosion of average selling prices. Price erosion experienced by any company can cause revenues and gross margins to decline. The average selling price of our products has decreased by approximately 65% from October 1995 to September 30, 2000. We expect this trend to continue.

In addition, we believe that the widespread adoption of industry standards in the soft modem industry is likely to further erode average selling prices, particularly for analog modems. Adoption of industry standards is driven by the market requirement to have interoperable modems. End users need this interoperability to ensure modems from different manufacturers communicate with each other without problems. Historically, users have deferred purchasing modems until these industry standards are adopted. However, once these standards are accepted, it lowers the barriers to entry and price erosion results. Decreasing average selling prices in our products could result in decreased revenues even if the number of units that we sell increases. Therefore, we must continue to develop and introduce next generation products with enhanced functionalities that can be sold at higher gross margins. Our failure to do this could cause our revenues and gross margin to decline.

Our gross margins may vary based on the mix of sales of our products and services, and these variations may hurt our net income.

We derive a significant portion of our sales from our software-based connectivity products. We expect margins on newly introduced products generally to be higher than our existing products. However, due in part to the competitive pricing pressures that affect our products and in part to increasing component and manufacturing costs, we expect margins from both existing and future products to decrease over time. In addition, licensing revenues from our products historically have provided higher margins than our product sales. Changes in the mix of products sold and the percentage of our sales in any quarter attributable to products as compared to licensing revenues will cause our quarterly results to vary and could result in a decrease in gross margins and net income.

Our future success depends on our ability to develop and successfully introduce new and enhanced products that meet the needs of our customers.

Our future success depends on our ability to anticipate our customers' needs and develop products that address those needs. Introduction of new products and product enhancements will require coordination of our efforts with those of our suppliers to rapidly achieve volume production. If we fail to coordinate these efforts, develop product enhancements or introduce new products that meet the needs of our customers as scheduled, our revenues may be reduced and our business may be harmed. We cannot assure you that product introductions will meet the anticipated release schedules.

Our revenues may fluctuate each quarter due to both domestic and international seasonal trends.

We have experienced and continue to experience seasonality in sales of our connectivity products. These seasonal trends materially affect our quarter-to-quarter operating results. Our revenues are typically higher in the third and fourth quarters due to the back-to-school and holiday seasons as well as purchasers of PCs making purchase decisions based on their calendar year-end budgeting requirements.

We are currently expanding our sales in international markets, particularly in Asia, Europe and South America. To the extent that our revenues in Asia, Europe or other parts of the world increase in future periods, we expect our period-to-period revenues to reflect seasonal buying patterns in these markets.

Any delays in our normally lengthy sales cycles could result in customers canceling purchases of our products.

Sales cycles for our products with major customers are lengthy, often lasting six months or longer. In addition, it can take an additional six months or more before a customer commences volume production of equipment that incorporates our products. Sales cycles with our major customers are lengthy for a number of reasons:

- . our original equipment manufacturer customers usually complete a lengthy technical evaluation of our products, over which we have no control, before placing a purchase order,
- . the commercial integration of our products by an original equipment manufacturer is typically limited during the initial release to evaluate product performance, and
- . the development and commercial introduction of products incorporating new technologies frequently are delayed.

A significant portion of our operating expenses is relatively fixed and is based in large part on our forecasts of volume and timing of orders. The lengthy sales cycles make forecasting the volume and timing of product orders difficult. In addition, the delays inherent in lengthy sales cycles raise additional risks of customer decisions to cancel or change product phases. If customer cancellations or product changes were to occur, this could result in the loss of anticipated sales without sufficient time for us to reduce our operating expenses.

We expect that our operating expenses will increase substantially in the future and these increased expenses may diminish our ability to remain profitable.

Although we have been profitable in recent years, we may not remain profitable on a quarterly or annual basis in the future. We anticipate that our expenses will increase substantially over at least the next three years as we:

- . further develop and introduce new applications and functionality for our host signal processing technology,
- . conduct research and development and explore emerging product opportunities in digital technologies and wireless and cable communications,
- . expand our distribution channels, both domestically and in our international markets, and
- . pursue strategic relationships and acquisitions.

In order to maintain profitability we will be required to increase our revenues to meet these additional expenses. Any failure to significantly increase our revenues as we implement our product, service, distribution and strategic relationship strategies would result in a decrease in our overall profitability.

To date, we have principally relied upon our distributor sales organization for product sales to smaller accounts. Our direct sales efforts have focused principally on board manufacturers and smaller PC original equipment manufacturers. To increase penetration of our target customer base, including large, tier-one original equipment manufacturers, we must significantly increase the size of our direct sales force and organize and deploy sales teams targeted at specific domestic tier-one original equipment manufacturer accounts. If we are unable to expand our sales to additional original equipment manufacturers, our revenues may not meet analysts' expectations which could cause our stock price to drop.

We must accurately forecast our customer demand for our products. If there is an unexpected fluctuation in demand for our products, we may incur excessive operating costs or lose product revenues.

We must forecast and place purchase orders for specialized semiconductor chips, such as the application specific integrated circuit, coder/decoder and discrete access array, or data access arrangement, components of our modem products, several months before we receive purchase orders from our own customers. This forecasting and order lead time requirement limits our ability to react to unexpected fluctuations in demand for our products. These fluctuations can be unexpected and may cause us to have excess inventory, or a shortage, of a particular product. In the event that our forecasts are inaccurate, we may need to write down excess inventory. For example, we were required to write down inventory in the second quarter of 1996 in connection with a product transition within our 14.4 Kbps product family. Similarly, if we fail to purchase sufficient supplies on a timely basis, we may incur additional rush charges or we may lose product revenues if we are not able to meet a purchase order. These failures could also adversely affect our customer relations. Significant write-downs of excess inventory or declines in inventory value in the future could cause our net income and gross margin to decrease.

We rely heavily on our intellectual property rights which offer only limited protection against potential infringers. Unauthorized use of our technology may result in development of products that compete with our products which could cause our market share and our revenues to be reduced.

Our success is heavily dependent upon our proprietary technology. We rely primarily on a combination of patent, copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect our proprietary rights. These means of protecting our proprietary rights may not be adequate. We hold a total of 43 patents, a number of which cover technology that is considered essential for International Telecommunications Union standard communications solutions, and also have 27 additional patent applications pending or filed. These patents may never be issued. These patents, both issued and pending, may not provide sufficiently broad protection against third party infringement lawsuits or they may not prove enforceable in actions against alleged infringers.

Despite precautions that we take, it may be possible for unauthorized third parties to copy aspects of our current or future products or to obtain and use information that we regard as proprietary. We may provide our licensees with access to our proprietary information underlying our licensed applications. Additionally, our competitors may independently develop similar or superior technology. Finally, policing unauthorized use of software is difficult, and some foreign laws, including those of various countries in Asia, do not protect our proprietary rights to the same extent as United States laws. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Litigation could result in substantial costs and diversion of resources.

We have received, and may receive in the future, communications from third parties asserting that our products infringe on their intellectual property rights, that our patents are unenforceable or that we have inappropriately licensed our intellectual property to third parties. These claims could affect our relationships with existing customers and may prevent potential future customers from purchasing our products or licensing our technology. Because we depend upon a limited number of products, any claims of this kind, whether they are with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require us to enter into royalty or licensing agreements. In the event that we do not prevail in litigation, we could be prevented from selling our products or be required to enter into royalty or licensing agreements on terms which may not be acceptable to us. We could also be prevented from selling our products or be required to pay substantial monetary damages. Should we cross license our intellectual property in order to obtain licenses, we may no longer be able to offer a unique product. Other than the ESS Technology and Smart Link lawsuits described elsewhere in the notes to the financial statements, no material lawsuits relating to intellectual property are currently filed against us.

New patent applications may be currently pending or filed in the future by third parties covering technology that we use currently or may use in the future. Pending U.S. patent applications are confidential until patents are issued, and thus it is impossible to ascertain all possible patent infringement claims against us. We believe that several of our competitors, including Lucent, Motorola and Texas Instruments, may have a strategy of protecting their market share by filing intellectual property claims against their competitors and may assert claims against us in the future. The legal and other expenses and diversion of resources associated with any such litigation could result in a decrease in our revenues and profitability.

In addition, some of our customer agreements include an indemnity clause that obligates us to defend and pay all damages and costs finally awarded by a court should third parties assert patent and/or copyright claims against our customers. As a result, we may be held responsible for infringement claims asserted against our customers.

If our financial reserves for potential future license fees are less than any actual fees that we are required to pay, our net income would be reduced.

We have established and recorded on a monthly basis a reserve for payment of future license fees based upon our estimate as to the likely amount of the licensing fees that we may be required to pay in the event that licenses are obtained. We believe that it is typical for participants in the modem industry to obtain licenses in exchange for grants of cross licenses rather than for payment of fees and we have based our estimates on our understanding of the license fee practices of other segments of our industry. Our reserves may not be adequate because of factors outside of our control and because these license fee practices in the modem industry may not be applicable to our experience.

Competition in the connectivity market is intense, and if we are unable to compete effectively, the demand for, or the prices of, our products may be reduced.

The connectivity device market is intensely competitive. We may not be able to compete successfully against current or potential competitors. Our current competitors include Conexant, ESS Technology, Lucent Technologies, Motorola, Smart Link, Broadcom, Texas Instrument, Centillium Communications, Metalink, Globespan and Virata. We expect competition to increase in the future as current competitors enhance their product offerings, new suppliers enter the connectivity device market, new communication technologies are introduced and additional networks are deployed.

We may in the future also face competition from other suppliers of products based on host signal processing technology or on new or emerging communication technologies, which may render our existing or future products obsolete or otherwise unmarketable. We believe that these competitors may include Alcatel, Analog Devices, Aware, Efficient Networks, IteX and Terayon Communications.

As a result of our February 2000 acquisition of Voyager Technologies, we anticipate that we will enter the markets for wireless Internet connectivity and wireless home networking. These markets are intensely competitive. We believe that our future competitors in these markets may include Aironet, Breezecom, Conexant, Lucent, Intersil, Motorola, Proxim and Symbol Technologies.

We believe that the principal competitive factors required by users and customers in the connectivity product market include compatibility with industry standards, price, functionality, ease of use and customer service and support. Although we believe that our products currently compete favorably with respect to these factors, we may not be able to maintain our competitive position against current and potential competitors.

In order for us to maintain our profitability and continue to introduce and develop new products for emerging markets, we must attract and retain our executive officers and qualified technical, sales, support and other administrative personnel.

Our past performance has been and our future performance is substantially dependent on the performance of our current executive officers and certain key engineering, sales, marketing, financial, technical and customer support personnel. If we lose the services of one or more of our executives or key employees, a replacement could be difficult to recruit and we may not be able to grow our business.

We intend to hire a significant number of additional engineering, sales, support, marketing and finance personnel in the future. Competition for personnel, especially engineers and marketing and sales personnel in Silicon Valley, is intense. We are particularly dependent on our ability to identify, attract, motivate and retain qualified engineers with the requisite education, background and industry experience. As of September 30, 2000, we employed a total of 73 people in our engineering department, over half of whom have advanced degrees. In the past we have experienced difficulty in recruiting qualified engineering personnel, especially developers, on a timely basis. If we are not able to hire at the levels that we plan, our ability to continue to develop products and technologies responsive to our markets will be impaired.

We have experienced significant growth in our business in recent periods and failure to manage our growth could strain our management, financial and administrative resources.

Our ability to successfully sell our products and implement our business plan in rapidly evolving markets requires an effective management planning process. Future expansion efforts could be expensive and put a strain on our management by significantly increasing the scope of their responsibilities and resources by increasing the number of people using them. We have increased, and plan to continue to increase, the scope of our operations at a rapid rate. Our headcount has grown and will continue to grow substantially. Our headcount increased from 95 at December 31, 1998 to 188 at September 30, 2000. In addition, we expect to continue to hire a significant number of new employees. To effectively manage our growth, we must maintain and enhance our financial and human resources systems and controls, integrate new personnel and manage expanded operations.

We rely on independent companies to manufacture, assemble and test our products. If these companies do not meet their commitments to us, our ability to sell products to our customers would be impaired.

We do not have our own manufacturing, assembly or testing operations. Instead, we rely on independent companies to manufacture, assemble and test the semiconductor chips, which are integral components of our products. Most of these companies are located outside of the United States. There are many risks associated with our relationships with these independent companies, including reduced control over:

- . delivery schedules,
- . quality assurance,
- . manufacturing costs,
- . capacity during periods of excess demand, and
- . access to process technologies.

In addition, the location of these independent parties outside of the United States creates additional risks resulting from the foreign regulatory, political and economic environments in which each of these companies exists. Further, some of these companies are located near earthquake fault lines. While we have not experienced any material problems to date, failures or delays by our manufacturers to provide the semiconductor chips that we require for our products, or any material change in the financial arrangements we have with these companies, could have an adverse impact on our ability to meet our customer product requirements.

We design, market and sell application specific integrated circuits and outsource the manufacturing and assembly of the integrated circuits to third party fabricators. The majority of our products and related components are manufactured by five principal companies: Taiwan Semiconductor Manufacturing Corporation, ST Microelectronics, Kawasaki/LSI, Silicon Labs and Delta Integration. We expect to continue to rely upon these third parties for these services. Currently, the data access arrangement chips used in our soft modem products are provided by a sole source, Silicon Labs, on a purchase order basis, and we have only a limited guaranteed supply arrangement under a contract with our supplier. Although we believe that we would be able to qualify an alternative manufacturing source for data access arrangement chips within a relatively short period of time, this transition, if necessary, could result in loss of purchase orders or customer relationships, which could result in decreased revenues.

Undetected software errors or failures found in new products may result in loss of customers or delay in market acceptance of our products.

Our products may contain undetected software errors or failures when first introduced or as new versions are released. To date, we have not been made aware of any significant software errors or failures in our products. However, despite testing by us and by current and potential customers, errors may be found in new products after commencement of commercial shipments, resulting in loss of customers or delay in market acceptance.

Risks Related to Our Industry

If the market for applications using our host signal processing technology does not grow as we anticipate, or if our products are not accepted in this market, our revenues may stagnate or decrease.

Our success depends on the growth of the market for applications using our host signal processing technology. Market demand for host signal processing technology depends primarily upon the cost and performance benefits relative to other competing solutions. This market has only recently begun to develop and may not develop at the growth rates that have been suggested by industry estimates. Although we have shipped a significant number of soft modems since we began commercial sales of these products in October 1995, the current level of demand for soft modems may not be sustained or may not grow. If customers do not accept soft modems or the market for soft modems does not grow, our revenues will decrease.

Further, we are in the process of developing next generation products and applications which improve and extend upon our host signal processing technology, such as a G.Lite modem solution and a remote access solution. If these products are not accepted in our markets when they are introduced, our revenues and profitability will be negatively affected.

Our industry is characterized by rapidly changing technologies. If we do not adapt to these technologies, our products will become obsolete.

The connectivity product market is characterized by rapidly changing technologies, limited product life cycles and frequent new product introductions. To remain competitive in this market, we have been required to introduce

many products over a limited period of time. For example, we introduced a 14.4 Kbps product in 1995, a 28.8 Kbps product in 1996, a 33.6 Kbps product in late 1996, a non-International Telecommunications Union standard 56 Kbps modem in the second half of 1997 and a V.90 International Telecommunications Union standard 56 Kbps modem in early 1998. The market for high speed data transmission is also characterized by several competing technologies that offer alternative broadband solutions which allow for higher modem speeds and faster internet access. These competing broadband technologies include digital subscriber line, wireless and cable. However, substantially all of our current product revenue is derived from sales of analog modems, which use a more conventional technology. We must continue to develop and introduce technologically advanced products that support one or more of these competing broadband technologies. If we are not successful in our response, our products will become obsolete and we will not be able to compete effectively.

Changes in laws or regulations, in particular, future FCC regulations affecting the broadband market, internet service providers, or the communications industry could negatively affect our ability to develop new technologies or sell new products and therefore, reduce our profitability.

The jurisdiction of the Federal Communications Commission, or FCC, extends to the entire communications industry, including our customers and their products and services that incorporate our products. Future FCC regulations affecting the broadband access services industry, our customers or our products may harm our business. For example, future FCC regulatory policies that affect the availability of data and internet services may impede our customers' penetration into their markets or affect the prices that they are able to charge. In addition, international regulatory bodies are beginning to adopt standards for the communications industry. Although our business has not been hurt by any regulations to date, in the future, delays caused by our compliance with regulatory requirements may result in order cancellations or postponements of product purchases by our customers, which would reduce our profitability.

Risks Related to our Common Stock

Substantial future sales of our common stock in the public market may depress our stock price.

Our current stockholders hold a substantial number of shares, which they will be able to sell in the public market in the near future. Sales of a substantial number of shares of our common stock could cause our stock price to fall.

Provisions in our charter documents may inhibit a change of control or a change of management which may cause the market price for our common stock to fall and may inhibit a takeover or change in our control that a stockholder may consider favorable.

Provisions in our charter documents could discourage potential acquisition proposals and could delay or prevent a change in control transaction that our stockholders may favor. These provisions could have the effect of discouraging others from making tender offers for our shares, and as a result, these provisions may prevent the market price of our common stock from reflecting the effects of actual or rumored takeover attempts and may prevent stockholders from reselling their shares at or above the price at which they purchased their shares. These provisions may also prevent changes in our management that our stockholders may favor. Our charter documents do not permit stockholders to act by written consent, do not permit stockholders to call a stockholders meeting and provide for a classified board of directors, which means stockholders can only elect, or remove, a limited number of our directors in any given year.

Our board of directors has the authority to issue up to 5,000,000 shares of preferred stock in one or more series. The board of directors can fix the price, rights, preferences, privileges and restrictions of this preferred stock without any further vote or action by our stockholders. The rights of the holders of our common stock will be affected by, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. Further, the issuance of shares of preferred stock may delay or prevent a change in control transaction without further action by our stockholders. As a result, the market price of our common stock may drop. The board of directors has not elected to issue additional shares of preferred stock since the initial public offering on October 19, 1999.

Our stock price may be volatile based on a number of factors, some of which are not in our control.

The trading price of our common stock has been highly volatile. Our stock price could be subject to wide fluctuations in response to a variety of factors, many of which are out of our control, including:

- . actual or anticipated variations in quarterly operating results,
- . announcements of technological innovations,
- . new products or services offered by us or our competitors,
- . changes in financial estimates by securities analysts,
- . conditions or trends in our industry,
- . our announcement of significant acquisitions, strategic partnerships, joint ventures or capital commitments,
- . additions or departures of key personnel, and
- . sales of common stock by us or our stockholders.

In addition, the Nasdaq National Market, where many publicly held telecommunications companies, including our company, are traded, often experiences extreme price and volume fluctuations. These fluctuations often have been unrelated or disproportionate to the operating performance of these companies. The trading prices of many technology companies continue to trade at multiples of earnings or revenues which are substantially above historic levels. These trading prices and multiples may not be sustainable. These broad market and industry factors may seriously harm the market price of our common stock, regardless of our actual operating performance. In the past, following periods of volatility in the market price of an individual company's securities, securities class action litigation often has been instituted against that company. This type of litigation, if instituted, could result in substantial costs and a diversion of management's attention and resources.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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We are exposed to minimal market risks. We manage the sensitivity of our results of operations to these risks by maintaining a conservative investment portfolio, which is comprised solely of high-grade securities. We do not hold or issue derivative, derivative commodity instruments or other financial instruments for trading purposes. We are exposed to currency fluctuations, as we sell our products internationally. We manage the sensitivity of our international sales by denominating all transactions in U.S. dollars.

We may be exposed to interest rate risks, as we may use additional financing to fund additional acquisitions and fund other capital expenditures. The interest rate that we may be able to obtain on financings will depend on market conditions at that time and may differ from the rates we have secured in the past.

Part II. Other Information
For the Three and Nine months Ended September 30, 2000

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Item 1 Legal Proceedings:

 See Note 4 of Notes to the Consolidated Condensed Financial
 Statements.

Item 2 Changes in Securities and Use of Proceeds: None.

Item 3 Defaults upon Senior Securities: None.

Item 4 Submission of Matters to a Vote of Security Holders: None.

Item 5 Other Information: None.

Item 6 Exhibits and Reports on Form 8-K:

 (a) Exhibits

Exhibit Number -----	Description -----
27.1	Financial Data Schedule for the nine months ended September 30, 2000.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PCTEL, Inc.
A Delaware Corporation
(Registrant)

November 14, 2000

/s/ Andrew Wahl

Andrew Wahl
Vice President, Finance and Chief Financial
Officer (principal financial and accounting
officer)

EXHIBIT INDEX

27.1 Financial Data Schedule

31

9-MOS
DEC-31-2000
JAN-01-2000
SEP-30-2000
76,488
55,211
21,383
3,215
8,771
163,922
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